DOW THEORY LETTERS INC.

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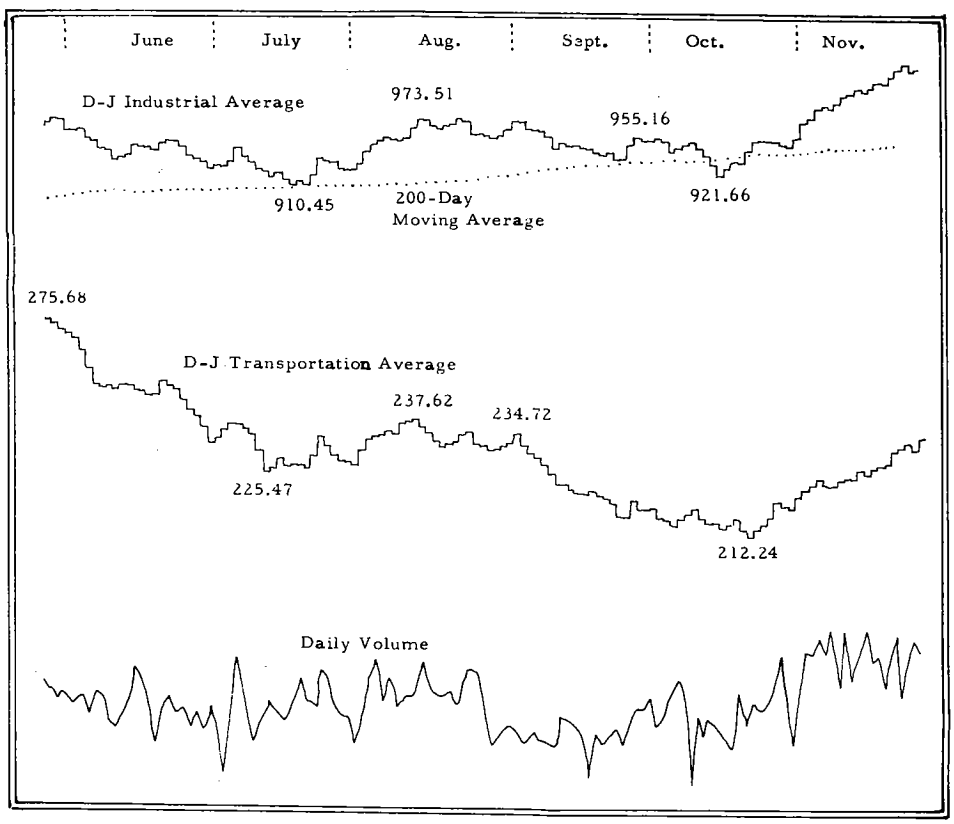
Nov. 17, Dow 1005.57, PTI 990, A-D ratio -1.92
Nov. 24, Dow 1025.21, PTI 1019, A-D ratio -1.33

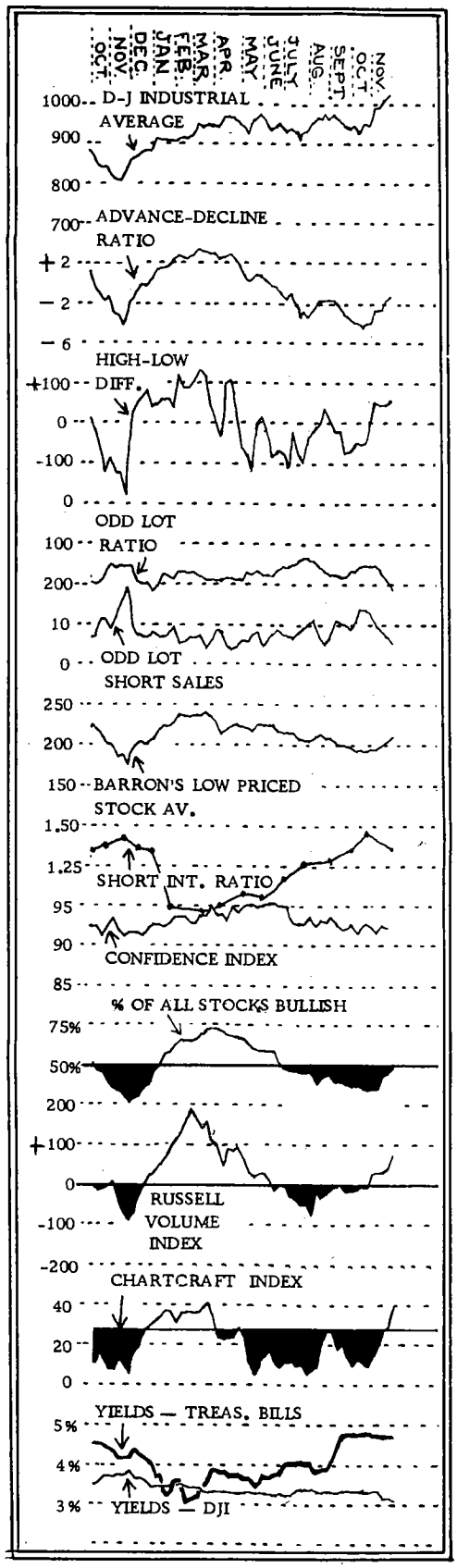
THE AVERAGES AND THE MARKET: Now that the Dow has passed 1000, the complaints about the Dow not being the "perfect Average" are dying down. One service notes that the Dow Industrial Average is simply a leading "technical indicator" and lets it go at that. Other services opine that the Dow is basically a "psychological indicator," the indicator which is synonomous with "the market" in the public's mind.

To me, the Dow is the time honored index of 30 leading blue chip stocks, stocks which make up a quarter of the value of all the 1462 common stocks listed on the NYSE. Furthermore (and most important) the Dow is the technical "standard" against which all other indices are compared as to harmonious or divergent movements. The Dow has the name, it has the history, and it is the only index which has been around since the turn of the century. We can say that Standard & Poor's 500 or the NYSE Average "would have done this or that in 1907," but the Dow was there. We KNOW how it acted.

To put it mildly, confusion now reigns in the market. The public is still standing on the sidelines holding its shares of American Standard or Dan River Mills or a few AMEX stocks, all of which are still bouncing around their lows of the past few years. The professionals are trading in the "movers," maybe loaded with Standard of California or Chrysler, and these gentlemen are mainly interested in next week, not whether it's a bull or bear market. Meanwhile, market students and the investors are scratching their heads, and trying to decide which is the sane approach to the whole thing. They can make some sort of a case for almost any opinion as to what this market is and where it is going.

I often try to look at the market as if I were an historian living in the year 2000. I might be studying the charts and describing what happened "back there in 1966 or 1972." What





would I see? We will assume that the arguments about the Dow Averages are still going on in the year 2000, despite the fact that by that time there are 39 new averages put forth by everyone from the Supermarket Association to the U.S. Treasury. But people in the year 2000 still (remarkably) follow the Dow Averages. And stock market history in the year 2000 continues to be written in terms of the Dow Theory, despite almost weekly complaints to the effect that the Theory is "outmoded" and that it is a dinosaur in a super-nuclear age.

One advantage of writing about the market years after the event is that one doesn't have to contend with the emotions of the time. It is hard to be bullish, for instance, in the face of a violent one-week sell-off. But a few years later when the psychology and emotions of the situation are forgotten, one can look back and say, "Ah, so that was what was happening."

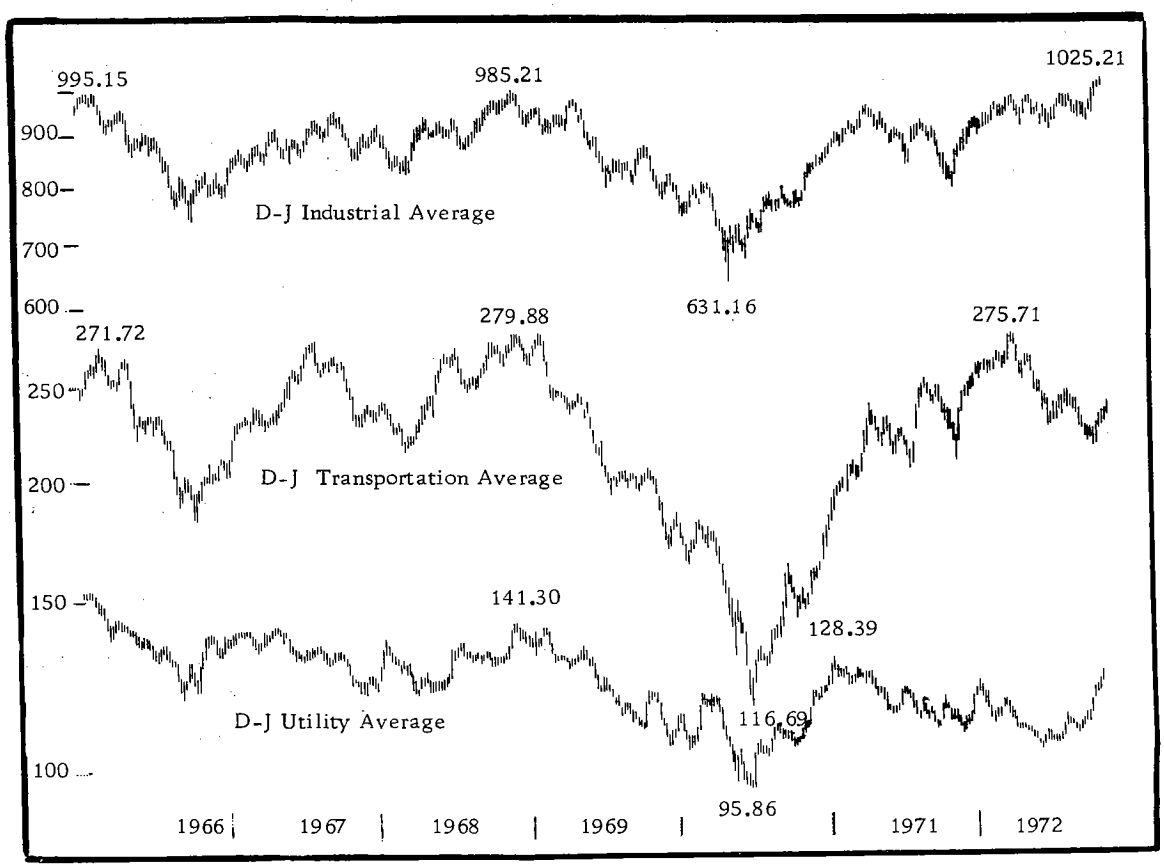
It has been said that charts are for statisticians with bad memories, so in order to aid readers who can't remember thousands of prices and dates, I am including one of my favorite charts, the weekly chart of the three D-J Averages drawn to semi-logarithmic or ratio scale. The ratio scale means that all movements in the three Averages can be correctly compared as to percentage of advance or decline. A rise of 10% in Utilities will appear on the chart as the exact same vertical distance as a rise of 10% in either of the other Averages.

First we note that on February 9, 1966, the Industrials topped out at 995.15. At around the same time the Transports topped at 271.72 (Utilities had hit their bull market high back in early 1965, a period not shown on this chart).

A major decline followed, taking the Industrials down to 744.32 in October, 1966. From there a new rise began. The new advance saw the Industrials hit an extreme peak in December, 1968, of 985.21. This was 10 points below the 1966 high. Despite the failure of Industrials to better the 1966 peak, Transports continued higher and in February, 1969, the Transports recorded an all-time high of 279.88.

Here, the failure of Industrials to confirm proved to be the forerunner of disaster. The market entered its worst collapse since the 1930's. By May 26, 1970, Industrials had dropped to 631.16. Two months later, on July 7, Transports closed at an extreme low of 116.69. (The Utility Average broke 100 and closed at 95.86 on June 30). At any rate, it is important to note that here the non-confirmation was on the downside (bullish) in that Industrials would not confirm the July 7 low in Transports. A new advance got underway.

By April 7, 1972, the Transports recorded a high of 275.71, just 4 points under their 1969 all-time high. Industrials went on to establish a series of new highs, 971.25 in May, 973.51 in August, and the famous "over 1000" in November. But as seen on the



chart, the Transports appeared to have "topped out for the duration."

All of which brings us to the present and to the problems of the present. Once again we have the spectacle of one Average (Industrials) in historic high territory while the other Average (Transports this time) has refused, at least up to this point, to confirm. (As a point of non-Dow Theory interest, Utilities are lower now than they were at the 1966 or 1969 tops, while the A-D ratio is at its lowest point ever with the Dow above 950).

The question — where are we now in classical Dow Theory terms? What will the market analysts of the year 2000 say about this whole extraordinary situation? And I might add that here in 1972 the situation is different than it was in 1966 or 1969. For then people were saying, "Who cares what the market is supposed to be, my stocks are up and I'm happy. Don't bother me with trends." Not so today, for the fact is that the public is stuck in a great many issues, and a great many issues have not come back even as the Dow moved over 1000. Thus, the question of classification appears more important now than ever.

Robert Rhea, the great Dow Theorist who wrote during the 1932-39 period, stated that a bull market terminates at the point of the "last confirmed highs" (in the two Averages, Industrials and Transports). By the same token a bear market is taken to have ended at the point of the last confirmed lows in both Averages.

Where does this leave us? In February, 1966, we had joint highs of 995.15 (Industrials) and 271.72 (Transports). At no time since then has there been a single day in which both Averages closed above those points. We have had periods in which one or the other Average closed above the 1966 highs but never a day of joint betterment of the '66 peaks.

If we make so bold as to add something to the Dow Theory we can say that neither the D-J Utilities nor the A-D ratio has been back to the 1966 highs, but the danger here is that another analyst can retort, "Yes, but the S & P Averages or the NYSE Averages have been higher," and then a second analyst can run up with the Value Line Average and state that this is still far below its 1969 high — and on and on. So personally, and with history on my side, I would prefer to interpret the market under strict Dow Theory terms, using just the D-J Industrial and Transport Averages. And under Dow Theory, I would say that 1966 will go down in history as the peak of the bull market which began in 1949.

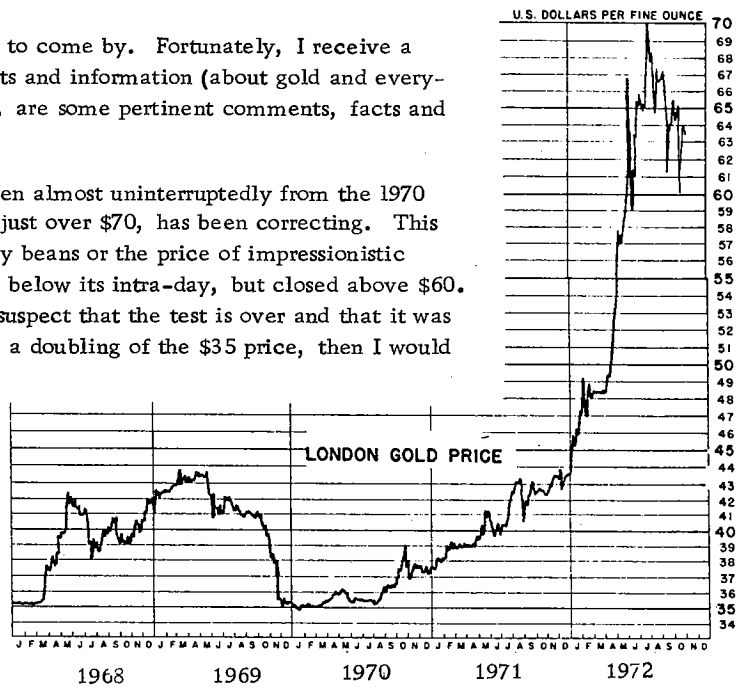
Why all the confusion, the reader asks? I will repeat what I have said so many times before. We have massive Government manipulation at this time, we have a Government with fantastic propaganda capabilities. We have 30 million people in the market. We have a market which responds to crowd psychology as never before. Thus, the great primary movements take longer today. The Government fights every decline tooth and nail. The Government battles every hint of recession, every indication of correction. And all the while it tolerates inflation in prices, inflation of the money supply, and debasement of our currency. Thus, millions of people have "retreated" into common stocks. Institutions such as giant pension funds have recently loaded up on common stocks. In fact, we have the picture of many pension funds (which need to generate income) buying up "growth" and "glamor" shares in an effort to "perform," rather than to supply income. Actually, a pension fund has no business in IBM or Burroughs, but that will all come out later. For the time being, suffice it to say that investors have sought to protect themselves against Government policies and the stock market has been one of the vehicles used for protection (perhaps I should change that to read "selected areas of the stock market").

Conclusion: The Industrials are now above their 1966 high of 995.15. If Transports can manage to better their 1966 high of 271.72 we will, for the first time, have both Averages at higher levels than 1966. Should this occur, I would be faced with two choices: (1) I could opine that the bull market which began in 1949 never ended, that it was battered and shattered all through 1966 to 1972 but that it somehow held together and that the Averages went on to record new confirmed highs. (2) The second choice would be to hold to the opinion that under the mass psychology of today, under the gargantuan Government manipulation and propaganda campaign, the Averages were forced into telling a "false story." The implication here would be that the movements of the Averages above the 1966 highs were manipulated and deceptive, and that such deception could only occur under the sponsorship of a Government which had run the nation to the edge of bankruptcy.

In the meantime, the Transports have not bettered their 1966 high of 271.72 nor have they bettered their 1969 all-time high of 279.88. Let's see what happens before we give it a name.

Note: In the November 27 Barron's there is an article by Joe Granville which takes the view that a new primary bull market began in 1970 and that phase one and two are passed with the third speculative phase still lying ahead. I do not subscribe to this view. I do not believe that a less-than-two year bear market (1969-70) corrected a 19-year bull market (1949 to 1968, I guess, is the way Joe counts it), nor does it seem plausible to me that two years after the "new bull market" began, Standard & Poor's 500 Stock Average would be at its lowest yield (it now yields 2.74%) in history! I do not want to make this a personal argument with Joe, but I simply do not agree from many standpoints.

GOLD: Gold information always seems hard to come by. Fortunately, I receive a steady stream of clippings, gossip, comments and information (about gold and everything else) from subscribers throughout the world. Following, are some pertinent comments, facts and charts regarding the gold picture.

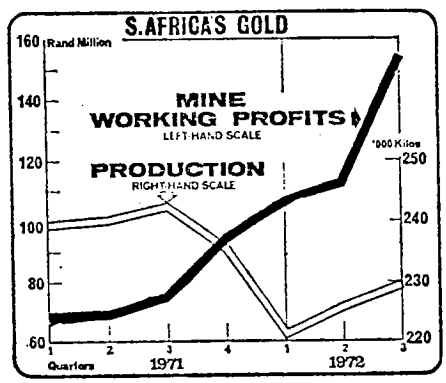


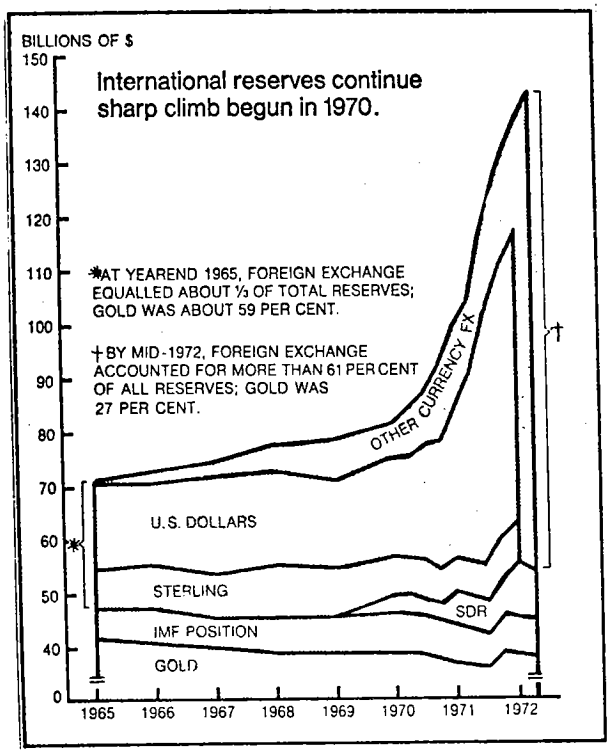
First, the London bullion price of gold (see chart), having risen almost uninterruptedly from the 1970 "official price" of $35 to the 1972 Free Market high price of just over $70, has been correcting. This is normal. Everything corrects, whether it be the price of soy beans or the price of impressionistic paintings. A few weeks ago gold tested the $60 level, broke below its intra-day, but closed above $60. Then it climbed to $64. I obviously can't be certain, but I suspect that the test is over and that it was successful. If so, if gold has only corrected to $60 following a doubling of the $35 price, then I would say that gold appears strong indeed. The same action in a stock would be considered sensational.

The quotes (prices) of S. African gold shares are largely made in London. ADR's tend to a large extent to reflect London prices. I am indebted to Indicator Digest (Palisades Pk, NJ 07650) for this... "There are technical factors relating to the London market which are adversely affecting the prices of Gold shares. At the beginning of the summer, due to the selling pressure on the British pound, the British Government imposed a premium of about 20% on the shares of companies located outside the British sterling area. This means that British purchasers pay 20% more for S. African Gold stocks. By contrast, The American Buyer of Gold shares in the London market has been subject to a 'mere' 11¼% Interest Equalization Tax. The big British bite naturally dampened demand for foreign securities, including Golds, on the important London Exchange."

So that meant technical pressure on Golds in their chief market, London. As to the fundamentals on Golds, they are still very good. The S. African Government now takes one-third of the mines' output into their reserves at the official $38 price. The other two-thirds the mines can sell on the Free Market price. The London Financial Times recently estimated that the mines have been receiving an average price of $55 for gold. They have probably been getting a little less since August, when the price of gold declined. The S. African Government "is reported to have confirmed" that the mines will eventually be given the difference between the official and the Free Market price for gold. "Thus, a potential reserve of extra profits is being built up for them," said the Times.

Working profits for the quarter ending September, 1972, were double that of the same quarter in 1971 in the S. African mines. The accompanying chart (courtesy of the London Financial Times) speaks pages regarding the mine profit picture. In a sentence, despite rising costs, the profit picture in the mines is excellent.





Next we come to a rather fascinating chart (at left) showing the international reserve picture since 1965. The chart is practically self-explanatory. We see that only seven years ago, in 1965, foreign exchange (dollars, pounds, other currencies) equalled only about 1/3 of total international reserves. Gold constituted 59% of reserves. Then the "ballooning process" began, the printing presses rolled. By mid-1972 foreign exchange made up over 61% of all foreign reserves, gold only 27%.

What does this mean? It means that the world's reserves are becoming merely a mountain of paper, paper which is basically a batch of I.O.U.'s. All of this paper is based on credit and faith, at a time when faith in paper is steadily declining, at a time when demands for credit are skyrocketing. Ultimately, (as all history indicates), the "piper must be paid," there must be a "real" settlement. There will come a time when nations (and men) will realize that they are collecting paper, paper which is losing value daily. This realization will probably be accompanied by panic and a rush for the value behind the paper — gold. When

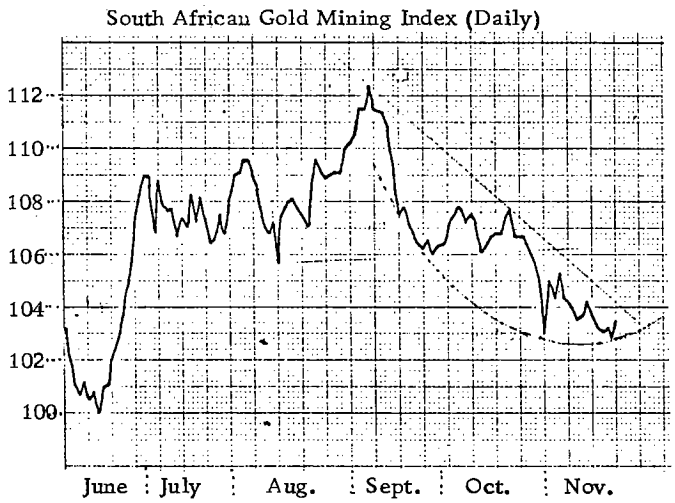
that happens, no force on earth will stop the price of gold from rising and rising. Gold shares, bullion, probably silver, all the monetary metals and shares connected with them will climb violently as the headlong rush to reality takes over. This is the reason why wise men, suspicious men, cynical men, men with a knowledge of history, conservative men, are all thinking about or buying gold shares. They know that it is not a question of whether — but of when.

Economist Eliot Janeway, just back from Johannesburg, is now recommending gold shares, not on the basis of any windfall, but on a yield basis (much as he recommended utilities very correctly many months ago)! Says Janeway in his Nov. 21 Janeway Letter, "Even assuming that the free market price of gold settles back to $50, dividend increases are coming. Better still, they will continue to come after the last 1972-early 1973 round of dividend declarations. The closely-knit club that controls all of them has been expensing as much cost as it can, and deferring as much profit as it can, from the big 1972 windfall it has been looking forward to for so long..."

I want to include this searching paragraph from Alden Well's November 13 Monetary Report (Box 401, Exeter, NH 03833). Wells is one of the small group of men in the nation who understand gold; he is one of the handful (count them on your fingers) of men anywhere who understand the Federal Reserve System. (This paragraph was written in mid-November, near the bottom of the gold decline).

GOLD

A pronounced change toward the role of gold in monetary affairs should be expected in the President's second term. In August of 1971 when he rejected the delivery of $3 billion gold to settle the Federal Reserve's short position in foreign currencies, he must have realized that both the Fed and Mr. Volcker had not known what they were doing. The 1972 Republican platform, unlike that of 1968, contained a plank calling for legal ownership of gold by Americans. Mr. Volcker will shortly resign. We do not know the sequence of events, but no reasonable President would want to set a new official price of gold and then subsequently remove legal restrictions on ownership. The latter must come first or the official price could not be sustained. As matters stand now, 40% of the world's reserves, including 90% of our own, are frozen because no government will sell gold at the official price of $38. The logjam will be broken. In the meantime gold now drifts downward as speculators who bought it at higher prices become impatient and sell. We expect them to come back into the market soon as buyers when they perceive the deterioration in European currencies. The neo-Keynesians lost their credibility August 15, 1971; the destruction has stunned governments; but in time gold will become the foundation of paper money.



For those who have not purchased golds or who wish to add to their golds I recommend Kloof, Vaal Reefs, Free State Geduld, President Steyn, Blyvoors, and American South African (latter of the NYSE, the others all available thru ADR's).

STOCKS: The strength in the Dow Industrials as seen in my technical charts improved markedly this past week. Of the 30 Dow Industrials, twelve had high (bullish) ratings of 4, 5, or 6 while only three had low (bearish) ratings of zero or 1.

I have included on page 6 a chart of American Telephone which enjoys the distinction of being the only Dow stock with a 6 rating. Note that the OBV in Telephone is extremely strong. Also note that the short interest in Telephone has climbed to 244 thousand (some of this could be arbitrage), but that is still a huge short interest. To top off the technical picture in Telephone, the odd-lot ratio has climbed to the 800 area, and this means that the public is selling 800 shares for every 100 purchased. I believe what has happened is that the public was panicked or discouraged when Telephone dropped into the low 40's (from the old high of 75). "How could this happen to staid old Telephone?" Disillusioned, the public is now accepting this rally as a golden opportunity to get out of the stock. My chart suggests that their instincts are wrong.

Does one trade Telephone? I simply don't know, but I do know that my chart is showing this stock to have a top rating. Telephone has climbed more than 10% above its moving average, and this often calls for a correction. But why fight it, a 6 rating is strong, very strong indeed.

Anaconda was reviewed in the last report. It had a rating of 4 then; it still does. Although the stock is down a fraction, one technical indicator has climbed so dramatically that I included the chart again. Of the 100 stocks for which the SEC issues weekly odd-lot statistics, Anaconda is second in terms of percentage of selling. Last week the Odd-lot ratio on Anaconda climbed to 1700 as is seen on the chart. With all this public selling, someone is obviously buying the stock and thereby holding it above its MA

(which stands at 18½). Anaconda could be ready to move out, and if it does the rise could be a good one.

A newcomer to strength of any kind is US Steel. Steel's 1959 high was 108 and here it is down in the 30's. "As Steel goes, so goes the market" was the market adage I grew up with, but no longer do we hear this ode to mighty Steel. Nevertheless, I rate Steel a high 5 now with all technical indicators pointing up and its odd-lot ratio particularly strong at 700. Both MO and RS in Steel have turned up over the past few weeks which means that not only is Steel bettering its price of 13 weeks ago but it is acting better than the market. The OBV pattern is also bullish. With Anaconda and Steel turning up, this could be a metals move building on the NYSE.

TECHNICAL CHARTS on the Dow stocks are constructed as follows:
Weekly high, low and closing price for each stock is plotted.

(1) Price fluctuates above or below a 10-week moving average (MA) of price. The MA is advanced three weeks in front of price. This is done because the process has been tested and provides the best buy and sell signals.
(2) On-Balance-volume (OBV) is cumulated volume. If a stock rises on a given day, all the volume for that day is considered plus, and is added to the previous day's total. The converse is applied if the stock declines. The Wednesday figure is plotted each week on the chart.
(3) If a short interest exists in the stock, it is shown on the chart.
(4) Relative strength (RS) is a ratio and indicates the stock's action compared with the "market." The market, in this case, is the S & P 500.
(5) The odd-lot ratio is the ratio of odd-lot buying to selling in the individual stock. These weekly ratios are plotted on the chart in the form of 4-week moving averages. When the odd-lot ratio rises it indicates a move towards selling, a declining line indicates less selling or buying. A ratio of 500 means 500 shares sold for each 100 bought; a ratio of 50 means 50 shares sold for each 100 bought.

Each of the five indicators is worth a point. Stocks are rated from zero (least strength) to 5 (most strength).